92-1304

Supreme Court, U.S.
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No.

In The

Supreme Court of the United States

October Term, 1992

JERRY WOOLUM,

Petitioner,

vs.

BANKONE, LEXINGTON, N.A.,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether grossly reckless conduct by a debtor in a nondischargeability action is sufficient to constitute an "intent to deceive" as required by 11 U.S.C. § 523(a)(2)(B)(iv).

2. Whether the appellate court's standard of review of whether a creditor's reliance was reasonable under bankruptcy section 11 U.S.C. § 523(a)(2)(B)(iii) is a *de novo* standard or whether the standard is clearly erroneous.

PARTIES BELOW

Jerry Woolum – Petitioner, Defendant, Debtor

BankOne, Lexington, N.A. – Respondent, Plaintiff, Creditor

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vs.

BANKONE, LEXINGTON, N.A.,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

A. United States Bankruptcy Court, Eastern District of Kentucky, Corbin Division, Opinion from the bench at the conclusion of the trial, August 22, 1991 and subsequent written judgment September 4, 1991.

B. United States District Court, Eastern District of Kentucky, London Division, Opinion dated December 20, 1991, reversing the Bankruptcy Court.

C. United States Sixth Circuit Court of Appeals, Opinion dated November 4, 1992, reversing the District Court.

STATEMENT OF JURISDICTION

1. The Sixth Circuit Court of Appeals entered its judgment reversing the United States District Court on November 4, 1992.

2. 28 U.S.C. § 1254(1) confers on this Court the jurisdiction to review by writ of certiorari the decision of the Sixth Circuit Court of Appeals.

STATUTES INVOLVED

11 U.S.C. §523(a) provides:

> A discharge under section 727, 1141, 1228(b) or 1328(b) of this title does not discharge an individual debtor from any debt. . . .
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit to the extent obtained by–
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> (B) use of a statement in writing–
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;

> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive; ...

STATEMENT OF THE CASE

This Petition requests that the United States Supreme Court review the decision of the Sixth Circuit Court of Appeals, which reversed the decision of the United States District Court, Eastern District of Kentucky, London Division. The district court itself had previously reversed the judgment of the United States Bankruptcy Court, Eastern District of Kentucky, Corbin Division. The bankruptcy court had held that two debts of the Petitioner/Defendant/Debtor Jerry Woolum to the Respondent/Plaintiff/Creditor BankOne, Lexington, NA (hereinafter "BankOne") would not be discharged pursuant to 11 U.S.C. § 523(a)(2)(B). The district court in reversing thus found that the debts should be discharged. The Sixth Circuit in reversing the district court said that the debts should not be discharged.

On September 21, 1990, this debtor, Jerry Woolum, and his brother, Kerry Woolum, filed Chapter 7 bankruptcies in the Eastern District of Kentucky, Corbin Division, pursuant to 11 U.S.C. § 101 *et seq.* The bankruptcy court thus had jurisdiction over that proceeding pursuant to 28 U.S.C. §§ 151, 157, and 1334. They were forced to file bankruptcy following the filing of Bankruptcy No. 90-1535 in the Eastern District of Kentucky by their brother-in-law, Dwight Winkler, on August 1, 1990. (Transcript of the Evidence of Trial, held on August 22, 1991, Plaintiff's Exhibit 32 [hereinafter "T.R.P.E. 32"]; Transcript of the Evidence of Trial

held on August 22, 1991, at page 158 [hereinafter "T.R. at 158"]).

The instant adversary proceeding was filed on December 24, 1990 by BankOne alleging that two debts owed to it by Jerry Woolum should not be discharged from bankruptcy because of the use of false financial statements. The jurisdiction of that adversary proceeding was pursuant to 28 U.S.C. §§ 157 and 1334.

At the conclusion of the trial on August 22, 1991, the bankruptcy court announced its findings of fact from the bench (T.R. at 189-196) and subsequently, on September 4, the court entered a judgment in this matter finding that the two debts should not be discharged pursuant to § 523(a)(2)(B), due to the use of false financial statements.

The debtor, Jerry Woolum, filed an appeal from that judgment and on December 20, 1991, the United States District Court for the Eastern District of Kentucky at London reversed the bankruptcy court and found that the debts should be discharged. BankOne appealed to the Sixth Circuit Court of Appeals, which on November 4, 1992 reversed the district court's judgment and reinstated the bankruptcy court's judgment.

BankOne is a large financial institution in Lexington, Kentucky with over $200 million in outstanding loans. (T.R. at 12). Through Linda Rumpke, its loan officer, BankOne made hundreds of thousands of dollars of loans in a two year period to a real estate development group headed by Rand Rogers for projects in both Richmond, Kentucky and Lexington. Jerry Woolum, a busy, practicing physician, was merely one of many partners in these developments. Jerry Woolum was never actively involved in the management of any of these projects. (T.R. at 47). Rand Rogers and others always were the developers and managing partners.

The specifics of the two subject loans are as follows: first,

Jerry Woolum borrowed $70,725 on April 22, 1988 to purchase a general partnership interest in Cottage Hearth Apartments.The note was renewed on April 22, 1989 and subsequently rewritten as a new $78,000 note on February 1, 1990. This note was current at the time of the bankruptcy filing.(*See* Joint Stipulation of Facts in the bankruptcy record below, hereinafter "J.S. Fact"). Second, he borrowed $225,000 on June 23, 1989 to purchase his partnership interest and the interest of his brother Kerry in the Patchen Oaks development. This note was also current at the time of the bankruptcy filing. (J.S. Fact). Jerry Woolum never received any financial benefit from either project or loan and forfeited his ownership interests in both in the bankruptcy process. (T.R. at 155-156).

BankOne additionally made three other loans to the developers individually or these partnerships which were not subject to this dischargeability action. First, a $20,000 working capital loan was made to Cottage Hearth Developers on January 13, 1989 which was renewed on January 13, 1990 and August 13, 1990. (J.S. Fact). Second, a $200,000 loan was made by BankOne to Rand Rogers, Jerry Woolum and others on June 23, 1989 to purchase a condominium in conjunction with the Patchen Oaks Project. (J.S. Fact). Third, the Bank made a $200,000 loan to Patchen Oaks Associates on September 15, 1989 for interim operating funds. (J.S. Fact).

Finally, a $7,000,000 loan was also made on June 23, 1989 by Kentucky Central to the Patchen Oaks Associates in conjunction with BankOne's $225,000 loan and BankOne's $200,000 loan described above. Although made by Kentucky Central, BankOne aggressively assisted the developers with this loan with Linda Rumpke even travelling to Pineville, Kentucky with the lead developer Rand Rogers to try to put together this financing package. (T.R. at 78, 52).

During the course of dealing with BankOne on these two projects, four of Jerry Woolum's financial statements were submitted to BankOne dated as follows: February 29, 1988, March 28, 1988, September 18, 1988 and April 11, 1989. (T.R.P.E. 1-4). Even though Ms. Rumpke aggressively courted this developer's business (Rand Rogers) and had extensive knowledge of the projects, BankOne claimed that it relied on Jerry Woolum's financial statements in making the two subject loans.

In spite of the well-known collapse of the real estate market, this adversary and even the bankruptcy itself would not have occurred without two sets of unfortunate circumstances. First, in September, 1989 the lead developer on these projects, Rand Rogers, died suddenly. (T.R. at 137). Jerry Woolum rightfully believes that had Rogers not died, the two real estate projects would not have developed the major problems that they did. (T.R. at 158, 195).

Second, Jerry Woolum trusted his brother-in-law, Dwight Winkler, who assured him that there was no basis to a nearly $400,000 lawsuit filed by Owens-Corning Fiberglas Corporation against him. In order to assist their brother-in-law Dwight Winkler in his insulation business, Jerry Woolum and Kerry Woolum had guaranteed obligations to Owens-Corning and All Weather Insulation. The business was Dwight's and Jerry Woolum did not participate at all in the management or operations of it. To his subsequent dismay, however, Jerry Woolum learned later that the obligations were real and they had been lied to by their brother-in-law. By trusting his brother-in-law as to the validity of the allegations, he allowed a nearly $400,000 default judgment to be taken against him. (T.R. at 145-147). These two debts were not included on his financial statements, because he honestly did not believe they were owed. (T.R. at 113, 115).

The largest debt, the $388,000 debt to Owens-Corning,

resulted in a garnishment of Jerry Woolum's bank accounts in April, 1989. The garnishment, however, was immediately released within a few days. (T.R. at 147 and T.R.P.E. at 31). This confirmed and validated to Jerry Woolum at the time that the debts were in fact not owed. The omission of these insulation related debts from his April, 1989 financial statement is what the bankruptcy court found to be grossly reckless, thus allowing the two subject loans to BankOne to be nondischargeable. The irony is that these insulation debts are what forced Jerry Woolum to file bankruptcy in the first place, when coupled with the problems on the two BankOne real estate developments that arose after Mr. Rogers' death. (T.R. at 158).

The bankruptcy court below held that the two subject loans should not be discharged because, even though the court found that Jerry Woolum did not intend to deceive BankOne, he was nonetheless "grossly reckless" in not getting a lawyer to investigate the debt to Owens-Corning further and prevent a default judgment from being entered against him. The bankruptcy court came to this conclusion even though the statute does not impose this burden on a debtor and the "grossly reckless" standard of intent used by the bankruptcy court is not present in the statute itself.

Although the court placed this burden on Jerry Woolum, it was absolutely silent as to why BankOne's alleged reliance was not unreasonable. The Bank knew the financial statement could not be accurate, because it had previously received the Owens-Corning garnishment itself. It thus knew that in spite of this omission from the financial statement, this debt was owed. The same standard on this issue should apply to the Bank as well.

The district court recognized this inconsistency and found that there was no reliance at all by BankOne with respect to the February, 1990 transaction and that even if there was reliance on

the June 23, 1989 transaction, such reliance was clearly unreasonable. The district court used a *de novo* review of the reasonableness of the Bank's reliance. The Sixth Circuit disagreed and reversed.

REASONS FOR GRANTING THE WRIT

Because of the high volume and great importance of bankruptcy cases in the federal courts and because of the resulting large numbers of published lower court opinions, this Court has decided an increasing number of bankruptcy cases where the issues are important and errors need to be corrected or conflicts resolved. This case is one such case for this Court to grant a Writ of Certiorari.

This case presents two such issues for this Court to review: first, the Sixth Circuit has ignored the plain language of the intent section on a false financial statement nondischargeability action; and second, a split in the circuits exists as to the standard of appellate review of the reasonableness of a creditor's reliance.

I.

THE BANKRUPTCY COURT AND THE SIXTH CIRCUIT COURT OF APPEALS IGNORED THE PLAIN LANGUAGE OF SECTION 523(a)(2)(B)(iv).

The bankruptcy court in the case below stated that the test to be used in determining the intent of the debtor under 11 U.S.C. § 523(a)(2)(B)(iv) (1988) is not actual intent, but instead is whether the debtor "acted in a *gross reckless manner* in not informing by way of listing on the financial statement the liabilities which had been asserted against him and in particular, the Owens-Corning liability in the amount of $388,000." (Emphasis added) (T.R. at 194). The Sixth Circuit Court of Appeals

in reversing the district court agreed with the bankruptcy judge that the legal standard is not the debtor's actual intent but instead is gross recklessness. The Sixth Circuit quoted with approval its prior decision *in In re Martin*, 761 F.2d 1163, 1167 (6th Cir. 1985) in which it had stated: "The standard . . . is that if the debtor either intended to deceive the Bank or acted with gross recklessness, full discharge will be denied."

This point is significant in the case at bar because of the bankruptcy court's belief that the debtor did not actually intend to deceive BankOne. "The testimony in part of the defendant [debtor] and the plaintiff's witness, Ms. Rumpke, both appears to the Court to be good, frank, honest and reliable testimony of their recollection of matters as best they recall them. The Court must put great credibility in the statements of both parties." (T.R. at 191, 192). Additionally, the court stated that it "believes the defendant's testimony in this regard and believes the defendant simply exercised extremely poor judgment. . . ." (T.R. at 194).

This Court has not had an opportunity to review the meaning of the phrase "intent to deceive" as it is found in 11 U.S.C. § 523(a)(2)(B)(iv) (1988). The importance of this language cannot be over-stated, particularly in light of this Court's decision in *Grogan v. Garner*, 111 S. Ct. 654 (1991). In *Grogan* this Court indicated that there is no special burden of proof on creditors who file dischargeability actions such as the one at bar. The prior clear and convincing burden of proof had served as an impediment to creditors initiating these actions. Thus, with nearly one million bankruptcies filed annually in the United States, creditors are initiating § 523(a)(2)(B) actions on an increasing basis after *Grogan*. The bankruptcy court below and the Sixth Circuit have chosen to ignore the plain language of this statute. Instead they have added by judicial fiat the phrase "recklessness" as part of the test for actual intent. This Court should now act to determine the proper test to be applied by the lower courts in this important area.

The statute is plain on its face, and this Court has made it abundantly clear in recent years that in such circumstances the analysis of a bankruptcy section begins and ends with the language of the statute itself. Thus, in *Toibb v. Radloff,* 111 S. Ct. 2197 (1991) this Court said: "In our view, the plain language of the bankruptcy code disposes of the question before us." *Id.* at 2199. The Court faced the question as to whether an individual debtor not engaged in business is eligible to reorganize under Chapter 11. The Court answered that question nearly unanimously in the affirmative, because there was no impediment to that in the plain language of the bankruptcy code.

Subsequently, in relying on *Toibb,* this Court in *Union Bank v. Wolas,* 112 S. Ct. 527 (1991) in a preferential transfer action, said that unforeseen consequences of a statute are not sufficient grounds to refuse to give effect to its plain meaning. *Id.* at 531. Additionally, the Court in *Grogan* indicated that statutory silence may not be used to support an interpretation contradicting the statute's plain meaning. Thus, in *Grogan,* where the statute was silent as to an argued greater burden of proof, this Court concluded that the silence implied that this higher burden was not required. *Id.* at 659. Similarly, in the case at bar, the absence of the additional language "gross recklessness" renders such an interpretation of the statute inconsistent with the plain meaning of the "intent" language. In another preferential transfer case, *Barnhill v. Johnson,* 112 S. Ct. 1386 (1992), the Court stated emphatically that only when there is "statutory ambiguity" is there a need to review legislative history. *Id.* at 1391. Likewise, in *Patterson v. Shumate,* 112 S. Ct. 2242 (1992), this Court stated once again that the plain language is "determinate" and that if the statutory language is clear, then an examination of legislative history is unnecessary. *Id.* at 2248. In that case the Court was examining the definition of property.

Likewise, in the case at bar, the words "intent to deceive" are

included in the statute and the additional phrase "reckless disregard" or "gross recklessness" is not included in the statutory language. The Sixth Circuit even recognized that an "intent to deceive" is not the same thing as "gross recklessness" when it stated that either is sufficient to satisfy the statute. *In re Woolum, et al.*, (6th Cir. Nov. 4, 1992) Slip Op. at 4. The "recklessness" part, however, is not in the statute. The bankruptcy court below believed that the debtor was reckless, but that he was well meaning and merely exercised "extremely poor judgment." (T.R. at 194). While this may be reckless behavior, the bankruptcy court itself acknowledged that this was not the same as an intent to deceive. Because the meaning of the language is clear, this Court should hear this matter and apply its recent rulings on statutory interpretation to this increasingly important part of bankruptcy practice.

II.

IN REVERSING THE DISTRICT COURT, THE SIXTH CIRCUIT COURT OF APPEALS APPLIED THE INCORRECT STANDARD OF REVIEW IN REINSTATING THE BANKRUPTCY COURT'S FINDING OF REASONABLE RELIANCE.

Before a creditor such as BankOne can prevail and have its debts declared nondischargeable, the creditor must prove under 11 U.S.C. § 523(a)(2)(B)(iii) that the creditor reasonably relied on the financial statements. As the district court below in its Memorandum Opinion at p. 17a, *infra*, stated: "[the] creditor must prove (1) it actually relied upon the financial statement, and (2) that this reliance was reasonable," citing *In re Myers*, 124 B.R. 735 (Bnkr. S.D. Ohio 1991). The Sixth Circuit Court of Appeals agreed that these are two separate issues upon which the creditor must prove and prevail.

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The district court held that the first requirement of actual reliance was a pure factual question, which was subject to the clearly erroneous standard of review. The Petitioner agrees that this is in fact a purely factual determination by the bankruptcy court, which should not be reversed by an appellate court unless it is clearly erroneous according to Bankruptcy Rule 8013.

The district court, however, also noted that the second requirement, that the reliance must be reasonable, is at a minimum a mixed question of law and fact, thus requiring *de novo* review. The Sixth Circuit, in reversing the district court, disagreed and held that the correct standard for appellate review of this reasonableness requirement is a clearly erroneous standard.

The Sixth Circuit also chose to follow the *In re Bonnett,* 895 F.2d 1155 (7th Cir. 1989) approach, rather than *In re Jordan,* 927 F.2d 221 (5th Cir. 1991) on this issue where the circuits have split. This Court should review the Sixth Circuit's decision because of this split in the circuits and because this Court needs to clarify the standard of review in a mixed question of law and fact in the bankruptcy context.

A. This Court Should Determine this Standard of Appellate Review Because the Circuits Are Split on the Issue.

A split in the circuits exists as to the proper standard of appellate review for the reasonableness of the creditor's reliance. The Fifth Circuit in *In re Jordan,* 927 F.2d at 225, held that the reasonableness of such reliance was a conclusion of law subject to *de novo* review. The Sixth Circuit, however, declined to follow *Jordan* and instead followed the holding in the Seventh Circuit, Ninth Circuit and Tenth Circuit that the reasonableness of reliance is a purely factual question and subject to the clearly erroneous standard. *In re Bonnett,* 895 F.2d at 1157; *In re Lansford,* 822 F.2d 902, 904 (9th Cir. 1987) and *In re Watson,* 958 F.2d 977, 978 (10th Cir. 1992).

With nearly a million bankruptcy cases filed in the United States annually and an increasing number of appeals, this Court should decide the proper standard for appellate review of the reasonableness of the creditor's reliance.

B. The Sixth Circuit Chose to Ignore Authority Dealing With Nearly Identical Issues.

The determination by the district court below that the clearly erroneous standard is required for the review of actual reliance, yet that a *de novo* standard is mandated for the review of the reasonableness of that reliance, is identical to the holdings of many federal courts in dealing with nearly identical bankruptcy code issues. The Sixth Circuit chose to ignore this authority. Therefore, where it is necessary to apply a legal test to a factual finding, the appellate courts initially defer to the trial court's factual finding unless clearly erroneous, yet review *de novo* that court's application of law to facts. Thus, for example, in *Hassler v. Assimos,* 53 B.R. 453 (C.D. Del. 1985), the court deferred to the bankruptcy court's determination that a delay occurred, but reviewed *de novo* whether the delay was excusable or not. "The conclusion, however, that a delay is inexcusable or that a party has suffered prejudice involves the application of legal standards over which this Court's review is plenary." *Id.* at 456. Similarly, in *In re Pilgrim,* 135 B.R. 314, 316 (C.D. Ill. 1992), the court stated, "The question of what constitutes 'substantial abuse' for the purposes of 11 U.S.C. § 707(b) is a matter of law, to be reviewed *de novo*."

Federal courts consistently hold that interpretations or analyses of facts require *de novo* review by the appellate courts. "Whether a particular activity constitutes a 'farming operation' under the statute should be evaluated as a legal question... the issue of whether a debtor is engaged in that particular activity is a factual issue." *In re Watford,* 898 F.2d 1525, 1527 (11th Cir. 1990). Whether factually determined overcharging was sufficient

wrongdoing to constitute a constructive trust is a question of law for *de novo* review. *In re Seneca Oil Co.*, 906 F.2d 1445, 1450 (10th Cir. 1990). Whether the abuse which actually occurred is "substantial" for 11 U.S.C. § 707(b) purposes is a matter of law to be reviewed *de novo. In re Green*, 934 F.2d 568 (4th Cir. 1991). "The question whether delay is 'inexcusable' on the facts presented is a conclusion of law over which our review is also plenary." *E.E.O.C. v. Great Atlantic & Pacific Tea Co.*, 735 F.2d 69, 81 (3rd Cir. 1984). The issue of whether a particular existing relationship rises to the level of fiduciary under 11 U.S.C. § 523(a)(4) is a legal question. *Ragsdale v. Haller*, 780 F.2d 794 (9th Cir. 1986). The requirement of good faith is a mixed question of fact and law. Therefore, the legal standard is *de novo. In re Abbotts Dairies of Pennsylvania, Inc.*, 788 F.2d 143, 147 (3rd Cir. 1986). Whether certain hardship is actually "undue", "requires a conclusion regarding the legal effect of the bankruptcy court's findings as to her circumstances." *Bruner v. New York State Higher Educ. Services*, 831 F.2d 395, 396 (2d Cir. 1987). Similarly, the Eighth Circuit in *Matter of Newcom*, 744 F.2d 621 (8th Cir. 1984) said that the question of when a "transfer" occurs is a legal determination based upon a review of the historical facts found by the judge. *De novo* review is the appropriate standard. *Id.* at 625.

The district court's conclusion in the case below was identical to the approach taken by all of the above courts. Thus, a conclusion as to historical facts found by a bankruptcy court (*i.e.*, whether reliance occurred) is reversible only if clearly erroneous. Similarly, when a court applies a legal test to these facts (*i.e.*, whether reliance is reasonable), that analysis is subject to a *de novo* review.

Once the Court applies the proper *de novo* review to the reasonableness issue, it is clear that the Bank's conduct was unreasonable and thus the bankruptcy court and Sixth Circuit should be reversed. Even if the Bank factually relied on these

statements, its reliance was not reasonable because the financial statements were incomplete, inconsistent, not signed, stale, and inaccurate. Most importantly, BankOne had actual knowledge of their inaccuracy because of its admitted prior receipt of the garnishment on the Owens-Corning debt.

The proper standard of appellate review of a trial court's interpretation of historical facts has yet to be reviewed by this Court in a bankruptcy context. As noted with the above authority on similar bankruptcy issues, the courts have routinely applied a *de novo* review. When examining the reasonableness of the reliance, the circuits are split and thus this Court for the first time should address these recurring issues.

CONCLUSION

This Court should grant the Writ of Certiorari so as to continue to hold in a bankruptcy context that the plain language of the statute controls and to resolve the split in the circuits over the proper standard of appellate review.

Respectfully submitted,

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APPENDIX A—OPINION AND JUDGMENT ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT FILED NOVEMBER 4, 1992

No. 92-5107

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

IN RE: JERRY WOOLUM; KAYETTA WOOLUM,

Debtors,

BANK ONE, LEXINGTON, N.A.,

Plaintiff-Appellant,

v.

DR. JERRY WOOLUM,

Defendant-Appellee.

On Appeal from the United States District Court for the Eastern District of Kentucky

Decided and Filed November 4, 1992Before: GUY and BATCHELDER, Circuit Judges; and LIVELY, Senior Circuit Judge.

LIVELY, Senior Circuit Judge. This case concerns the dischargeability in bankruptcy of a bank debt. We conclude that the district judge applied the wrong standard of review on appeal from a decision of the bankruptcy court and, accordingly, we reverse the judgment of the district court.

Appendix A

I.

Jerry Woolum, a physician, was not a customer of Bank One. In 1988, he was introduced to the bank's leading officer, Linda Rumpke, by an established customer, real estate developer Rand Rogers. Woolum applied for and received a loan for the purpose of investing in one of the Rogers' developments. Before approving the loan, the bank required Woolum to file a financial statement. Over the next two years Bank One made a series of individual and partnership loans to Woolum and during this time he submitted three additional financial statements. In addition the bank required Woolum to produce his individual income tax returns, and the bank obtained a credit report. The tax returns showed income in excess of $300,000 per year and the credit check was consistent with other information that Woolum furnished.

Things did not go well for Dr. Woolum, however, and he filed a petition in bankruptcy on September 21, 1990. It appears that two judgments against Woolum as guarantor of obligations incurred by a corporation run by his brother-in-law precipitated his resort to bankruptcy. He was also a stockholder in the corporation. At the time of the bankruptcy filing, two of Woolum's promissory notes to Bank One were outstanding. These were a note for $78,000 dated February 1, 1990, renewing an April 22, 1988, note and one for $225,000 dated June 23, 1989. Both loans were made in connection with purchases by Woolum of interests in developments of Rand Rogers. In his Chapter 7 bankruptcy case Woolum sought discharge from his bank debts as well as his obligations as guarantor.

None of Woolum's financial statements listed the two guaranty obligations as debts or liabilities. Both guaranties predated Woolum's first contact with Bank One and both involved

substantial amounts. Woolum had signed a guaranty to Owens-Corning Corporation in 1982 that eventually resulted in a claim for more than $388,000, and one to All Weather Insulation Co. that Resulted in a judgment against him in excess of $75,000.

II.

One result of bankruptcy is the discharge of the bankrupt debtor form preexisting financial obligations. Section 523 of the bankruptcy Code lists circumstances that result in exceptions to the general rule of discharge. Bank One objected to the discharge of Woolum's obligation and filed an adversary proceeding against Woolum, asserting that the debtor's intentional use of false financial statements should bar discharge of his indebtedness to the bank under 11 U.S.C. § 523(a)(2)(B). That section of the Code provides:

> (a) A discharge . . . does not discharge an individual debtor from any debt—
>
> * * *
>
> (2) for money, property, services, or an extension, renewal or refinancing of credit, to the extent obtained by —
>
> * * *
>
> (B) use of a statement in writing —
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;

> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonable relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive . . .

The bankruptcy judge conducted an evidentiary hearing at which Dr. Woolum and Linda Rumpke testified. The parties stipulated that two of the four statutory elements of non-dischargeability were satisfied: the statements were materially false and were given with respect to Dr. Woolum's financial condition. The questions to be decided by the bankruptcy court were whether the bank reasonably relied upon the statements in making the loans and whether the statements were given with intent to deceive. Although Dr. Woolum testified that he relied on assurances of his brother-in-law that the claim by Owens-Corning was "a mistake" and that he had forgotten the guaranty to All Weather Insulation, the bankruptcy judge found that Woolum acted at least with gross recklessness in failing to list these obligations on the financial statements. Because gross recklessness is sufficient to establish an intent to deceive, this finding satisfied the fourth requirement of § 523(a)(2)(B). See *In re Martin*, 761 F.2d 1163, 1167 (6th Cir. 1985) ("The standard . . . is that if the debtor either intended to deceive the Bank or acted with gross recklessness, full discharge will be denied.").

The most vigorously contested issue at all levels has concerned the determination of whether Bank One established existence of the third statutory element of non-dischargeability — reasonable reliance by the lender on the written financial statements. Dr. Woolum has argued, and continues to contend, that

the facts show that the bank did not rely on the financial statements. Rather, he asserts that the bank relied on his medical earnings. He points to many "red flags" in the financial statements that should be found to negate reasonable reliance. He contends that the statements were incomplete, at least one was unsigned, and they were "stale" at the time the bank approved and made the loans. He also states that Ms. Rumpke knew that some of the statements were incomplete, that his wife's assets were improperly listed, and his partnership interests were "miscategorized" on some of the statements. Finally, he argues that the bank made the loans to him in order to keep Rand Rogers' business, and that his financial condition was not a factor in the decision to make the loans.

The bank responds that there were no "red flags." While the financial statements were not perfect, the bank asserts the mistakes were of a type commonly found on individual financial statements, and they did not affect the bank's reliance. Ms. Rumpke testified that she went over the statements item by item, examined the tax returns and credit reports and noted Dr. Woolum's professional success and business experience before granting the loans. She stated unequivocally that she did rely on the financial statements in approving Dr. Woolum's requests for loans. The bankruptcy judge found her a credible witness.

Dr. Woolum contends that one "red flag" in particular should be held to negate reliance on the statements. In connection with its efforts to collect on Woolum's guaranty of the corporation's debt, Owens-Corning served a garnishment on Bank One following entry of a default judgment on April 4, 1989. The order of garnishment directed the bank to hold any property or funds of Dr. Woolum in possession of the bank until further orders of the court. Because Woolum had no accounts with the bank, there was nothing in its possession subject to garnishment, and the bank returned the

garnishment order to the issuing court with a return of "no accts." Dr. Woolum argues that receipt of the garnishment order put the bank on notice that he had a large liability that was not shown on any of the financial statements, requiring further inquiry by the bank and negating reasonable reliance on the statements.

The bank responds that Ms. Rumpke had no reason to know of the garnishment action. The clerk who received the notice followed the usual practice of checking to determine whether the bank held any funds or property of Dr. Woolum. When she found that the bank had no funds or accounts subject to the order, she again followed normal procedure and returned the notice marked "no accts." Ms. Rumpke testified she had no reason to know of the existence of the order,

III.

A.

The bankruptcy court focused on the financial statement dated April 11, 1989. Just one month before submitting that statement, Dr. Woolum had been served with a summons in the suit by Owens-Corning seeking to recover $388,000 from him. His failure to list the Owens-Corning guaranty as an obligation less than one month after receiving the summons was the clearest example of gross recklessness amounting in law to an intent to deceive. This omission had particular significance because the bank made the unsecured loan for $225,000 just two months later, in June 1989. The bankruptcy judge stated in his oral opinion:

> While there is evidence that there were significant inconsistencies in the financial statements provided by the debtor to the bank,

> the Court finds the bank reasonably relied upon the financial statements and in particular, the net worth set forth therein in making the loans to the defendant. It seems self-evident that the bank relied upon the April 11, 1989 statement, in particular, and the conduct of the bank, the Court deems to be reasonable under the circumstances.

Based on its findings the bankruptcy court entered judgement denying dischargeability to the two bank loans in question.

B.

The district court, on appeal, reversed the judgement of the bankruptcy court. The court found that the April 1989 financial statement, which showed a net worth of $1,324,000, contained "significant inaccuracies." In addition to failing completely to disclose the two obligations which he had unconditionally guaranteed, Dr. Woolum had listed only a proportionate share of several join obligations when he was actually liable for the total indebtedness. On this basis the district court found that the element of intent to deceive was "certainly established." While agreeing with the bankruptcy judge's finding of gross recklessness, the district judge wrote: "Indeed, the record would easily support a finding of actual, deliberate intent to deceive."

With respect to the issue of reliance, the district court determined that it must answer two questions. First, did the bank actually rely on the written statements; second, was its reliance reasonable? The district court held that the first question is purely factual and the bankruptcy court's findings should be reviewed under a clearly erroneous standard. On the other hand, the district court concluded that the question whether any reliance was

reasonable " would present, at the least, a mixed question of law and fact requiring and *de novo* review." Proceeding on this basis, the district court agreed that the bank actually relied on the statements in making the June 1989 $225,000 loan, but that the funding of actual reliance in making the February 1990 $78,000 loan was clearly erroneous. Then, upon *de novo* review of the record, the court held that any reliance was "clearly unreasonable."

Among the circumstances that led the district court to this conclusion were the fact that Dr. Woolum did not sign the April 1989 financial statement, that a properly signed statement nine months old at the time of the June 1989 loan was "stale," and that numerous "red flags" were present to alert the bank that reliance on the statements would be unreasonable. The court referred to blank spaces in the statements, inaccuracies of which Ms. Rumpke was aware, and the garnishment notice. Although the record showed that local banks would not follow a practice of notifying their loan officers when a garnishment was attempted on someone who had no accounts at the bank, the district court held that the garnishment clerk should have informed Ms. Rumpke and that it was unreasonable for her not to inquire about garnishments. The district court did not mention Ms. Rumpke's testimony that the inaccuracies and omissions were common on personal financial statements, that the bank customarily relied on financial statements for up to one year, and that she did in fact rely upon the statement. Also, the district court appears to have overlooked the fact that Dr. Woolum acknowledged that the unsigned statement was his, submitted for the same purposes as the signed ones. The court made no finding on whether or not the bank acted in good faith.

IV.

Appendix A

A.

The district court committed reversible error in determining that reasonable reliance by a lender is a mixed question of law and fact, and then reviewing the bankruptcy court's decision under a *de novo* standard. We stated in *In re Ledford*, 970 F.2d 1556, 1560 (6th Cir. 1992) that "[w]hether a creditor's reliance was reasonable is a factual determination to be made in light of the totality of the circumstances." As a factual determination, this finding must be reviewed under the deferential clearly erroneous standard. Bankruptcy Rule 8013.

Although the district court did not have the benefit of our Ledford decision, this court had made clear previously that a finding of reasonable reliance is subject to review under the clearly erroneous standard. We staled in *In re Phillips*, 804 F.2d 930, 932 (6th Cir. 1986), that the findings of fact unless they are clearly erroneous." *Phillips* arose under § 523(a)(2)(A)[1] rather than under § 523(a)(2)(B). Nevertheless, the *Phillips* court adopted a statement from *In re Martin*, 761 F.2d 1163, 1166 (6th Cir. 1985), that "[t]he determination of reasonableness must be made by evaluating all the facts and circumstances of the case." *Phillips*, 804 F.2d at 933. Martin involved a claim of non-dischargeability under § 523(a)(2)(B), as does the present case. Thus, the same standard applies to determinations of the reasonableness of a lender's reliance whether the inquiry is under § 523(a)(2)(A) or (B). The *Phillips* court applied this standard both to the inquiry whether there was intent to deceive and whether the lender's reliance was reasonable. Also, citing *Martin*, this court conducted

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1. Section 523(a)(2)(A) withholds discharge from debts for money etc. obtained by "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition."

a clearly erroneous review of reasonableness in *Knoxville Teachers Credit Union v. Parkey,* 790 F.2d 490 (6th Cir. 1986), another § 523(a)(2)(B) case. There can be no doubt that this is a factual question under established Sixth Circuit law.

Our view of the matter is in accord with holdings of the Courts of Appeals for the Seventh, Ninth and Tenth Circuits. See *Matter of Bonnett,* 895 F.2d 1155, 1157 (7th Cir. 1989); *In re Lansford,* 822 F.2d 902, 904 (9th Cir. 1987); *In re Watson,* 958 F.2d 977, 978 (10th Cir. 1992). We decline to follow the holding of the Court of Appeals for the Fifth Circuit in *Matter of Jordan,* 927 F.2d 221, 225 (1991), where that court found that the reasonableness of reliance was a conclusion of law subject to *de novo* review.

B.

Once it has been established that a debtor has furnished a lender a materially false financial statement, the reasonableness requirement of § 523(a)(2)(B) "cannot be said to be a rigorous requirement, but rather is directed at creditors acting in bad faith." *Martin,* 761 F.2d at 1166. A district court reviewing a bankruptcy court's determination of reasonable reliance is not "to undertake a subjective evaluation and judgement of a creditor's lending policy and practices." *Matter of Garman,* 643 F.2d 1252, 1256 (7th Cir. 1980), *cert. denied,* 450 U.S. 910 (1981). We cited and relied upon *Garman* in *Martin, Phillips* and *Ledford* as stating the correct approach to determining the reasonable reliance issue.

Applying these standards, we conclude that the bankruptcy court's findings that Bank One actually relied upon Dr. Woolum's written financial statements in making the two loans that it seeks to except from discharge and that this reliance was reasonable are not clearly erroneous. There was absolutely no showing that the bank

acted in bad faith. *Martin*, 761 F.2d at 1166. In *Knoxville Teachers*, 790 F.2d at 492, n.2. we adopted the following statement from *Garman*, 643 F.2d at 1258:

> The present issue for the court is simply whether the bankrupt obtained credit, or a renewal, through the creditor's reliance on a materially false financial statement containing information apparently sufficient to obtain an accurate picture of the debtor's financial condition with regard to a reasonable decisional factor in the loan decision, filed by the debtor with the intent to deceive the creditor. The creditor need establish only its reliance in fact, although its claims to reliance cannot be so unreasonable as to defeat a finding of reliance in fact. Given this reliance, the court, with the benefit of hindsight, should not base its decision regarding discharge on whether it would have extended the loan. (emphasis in original).

The district court appears to have based its incorrect *de novo* determination upon a conclusion that it would not have extended the loan. This approach compounded the error of applying the wrong standard of review.

The judgement of the district court is reversed. The case is remanded with directions to reinstate the judgement of the bankruptcy court denying dischargeability to the two loans in question.

Appendix A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No: 92-5107

In re: JERRY WOOLUM; KAYETTA WOOLUM,

Debtors.

BANK ONE, LEXINGTON, N.A.,

Plaintiff-Appellant,

v.

DR. JERRY WOOLUM,

Defendant-Appellee.

Before: Guy and Batchelder, Circuit Judges; Lively, Senior Circuit Judge

JUDGMENT

ON APPEAL from the United States District Court for the Eastern District of Kentucky at London.

THIS CAUSE was heard on the record from the district court and was argued by counsel.

ON CONSIDERATION WHEREOF, it is ordered that the judgment of the district court is reversed, and the case is remanded with directions to reinstate the judgment of the bankruptcy court denying dischargeability to the two loans in question.

Appendix A

ENTERED BY ORDER OF THE COURT
s/ Leonard Green
Leonard Green, Clerk

Issued as Mandate: 11/30/92

COSTS: $227.10

Filing Fee . . . . . $
Printing . . . . . $
Total . . . . . .$

A True Copy.

Attest:
s/ Diane Schnur
Deputy Clerk

APPENDIX B — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF KENTUCKY FILED DECEMBER 20, 1991

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY
LONDON

CIVIL ACTION NO. 91-254

JERRY WOOLUM,

APPELLANT

VS:

BANK ONE, LEXINGTON, N.A.,

APPELLEE

MEMORANDUM OPINION

INTRODUCTION

This case is currently before the Court on the appeal of the debtor, Dr. Jerry Woolum, from a decision of the Bankruptcy Court concluding that two debts owed Bank One by the debtor were excepted from discharge under the provisions of 11 U.S.C. Section 523(a)(2)(B). The jurisdiction of this Court is alleged under the provisions of 28 U.S.C. Section 158(a).

FACTS

Debtor Woolum is a physician with a Pineville practice focusing on family medicine and surgery. In September of 1988, Woolum first approached Bank One seeking a loan. The appellant

wanted the loan in order to purchase a general partnership interest in Cottage Hearth Developers, a real estate project being developed by his friend, Rand Rogers. Rogers had a well-established relationship with Bank One as a reliable customer and was responsible for introducing Woolum to Bank One loan officer, Linda Rumpke.

Woolum received from Bank One, during the next two years, either individually or with his partners, a series of loans, only two of which are the subjects of this appeal. On April 22, 1988, the bank loaned the debtor $70,725.00 to purchase the Cottage Hearth partnership interest. This note was renewed in April of 1989 and rewritten as a new note for $78,000.00 on February 1, 1990. This February, 1990 note is one of the obligations the bank seeks to except from discharge.

The second loan which Bank One seeks to except from discharge was a loan for $225,000.00 made on June 23, 1989. The loan was extended in order for Woolum to purchase a partnership interest for himself and his brother, Kerry Woolum, in Patchen Oaks, another Rogers development project. The loan was unsecured since all of the appellant's cash assets were within his retirement account and could not be pledged.

The record indicates that Bank One made several other loans to Woolum which are not subject to this appeal. A loan for $20,000.00 was extended to the Woolum and the other partners on the Cottage Hearth project in January of 1989. This loan was renewed on January 13, 1990 and again on August 13, 1990. A loan for $200,000.00 was extended to Woolum, Rogers and certain other individuals on June 23, 1989 in other to purchase a condominium in conjunction with the Patchen Oaks project. On September 15, 1989, the Bank loaned the Patchen Oaks partners $200,000.00 for interim operating funds.

Appendix B

On June 23, 1989, the partners on the Patchen Oaks project, including Woolum, closed a $7,100,000.00 for the financing of the project with Kentucky Central Life Insurance Company. Rumpke was aware of this loan and was apparently active in arranging it after Bank One was unable to provide the financing due to the large size of the loan required.

As part of the loan application process, Woolum was required to submit a financial statement to the bank. In the course of Woolums relationship with the Bank One, he submitted four financial statements to them. These statement were submitted in February, 1988, March, 1988, September, 1988, and April, 1989. The last statement indicated a net worth of $1,324,000.00. The appellant's financial statements were inaccurate as a result of his failure to disclose his liability as a co-maker and guarantor on several transactions. The majority of debts that were disclosed indicated his proportionate liability on several joint obligations rather than the total amount of actual liability. Most significantly, the debtor never disclosed his liability as a guarantor for two debts of Dwight Winkler's (Woolum's brother-in-law) insulation business, in which the debtor was also a stockholder. The first guaranty was signed on December 14, 1982 in favor of Owens-Corning Fiberglass Corporation. The appellant also signed a guaranty in the fall of 1988 in favor of All Weather Insulation.

Woolum claims that he did not initially disclose the Owen-Corning guaranty since he forgot about it. However, on March 10, 1989, the appellant received a summons and complaint from Owens-Corning suing him for $388,595.69 based on the guaranty. The debtor claims to have believed his brother-in-law that no obligation was owed when Winkler told him it was a mistake. Owens-Corning later obtained a default judgment on the obligation. Accounts of the debtor were garnished in May of 1989,

although the garnishment was later released. Nevertheless, supposedly based on Winkler's assurances that no obligation was owed, the appellant never informed Bank One about this claim. Woolum also claims to have believed that he did not owe a debt to All Weather based on the statements of Winkler despite receiving demand for payment in June of 1989.

The Court notes that Bank One was one of the institutions upon which Owens-Corning attempted garnishment, attempting a levy on May 11, 1989. Since Woolum did not have an account at the bank, the garnishment was returned. The banks office which received the garnishment order did not notify Rumpke or anyone in the loan department concerning the attempted garnishment, nor would such practice appear to be a procedure used by local banks. Rumpke also did not check with the garnishment office prior to the two contested loans.

Woolum filed for bankruptcy on September 21, 1990. Bank One initiated, in December of 1990, an adversary action to contest discharge of the two aforementioned loans of June 23, 1989 and February 1, 1990 as a result of the false financial statement. Following a trial on August 21, 1991, the Bankruptcy Court issued a decision finding that the appellant had intentionally deceived Bank One, that the bank, under the circumstances, had reasonably relied upon the financial statements and an exception to discharge under Section 523(a)(2)(B) should be made. Woolum appealed to federal district court and the case is now ripe for decision.

DISCUSSION

Bank One argues that the Bankruptcy Court decision in its favor should be affirmed. The appellee asserts that, under prevailing Sixth Circuit Court of Appeals precedent, the

Bankruptcy Court properly found that Woolum intentionally deceived it by grossly and recklessly failing to disclose the information concerning the guaranty to Winkler's business and understating the size of loan obligations. The bank also argues that the Bankruptcy Court properly concluded that it reasonably relied on the false financial statements in making the two disputed loans under the circumstances of the case. The appellant argues that he did not manifest the required intent to deceive under Section 523(a)(2)(B). He also argues that the appellee's reliance upon the financial statements was not reasonable. After a review of the evidence presented, the undersigned concludes that the Bankruptcy Court's decision must be reversed.

Four elements must be proven by a creditor in order for a debt to be found to be an exception to discharge under Section 523(a)(2)(B). The creditor must show that the debtor obtained money, property, or services through the use of a materially false written statement, that the false statement concerned the debtor's financial condition, that the debtor caused the financial statement to be made with the intent to deceive the creditor, and that the creditor reasonably relied on the financial statement in extending the credit. *In Re Martin*, 761 F.2d 1163 (6th Cir. 1985). In the present case, Woolum concedes that he obtained the two loans using a materially false written statement concerning his financial condition, thereby establishing the first two elements. The parties vigorously contest the latter two elements.

The Court first examines the third element concerning whether Woolum intentionally deceived Bank One. The Bankruptcy Court found that Woolum acted in a grossly reckless fashion in not disclosing to the bank the information concerning the two guaranty obligations. The appellant alleges that the grossly reckless standard is not appropriate under Section 523(a)(2)(B)

and that the standard should be his actual intent. However, the Sixth Circuit Court of Appeals in the aforementioned *In Re Martin* decision as well as in the subsequent cases of *Knoxville Teachers Credit Union v. Parkey*, 790 F.2d 490 (6th Cir. 1986) and *In Re Phillips*, 804 F.2d 930 (6th Cir. 1986) endorsed the grossly reckless standard as being sufficient for the intent element under Section 523(a)(2)(B). "The standard, however, is that if the debtor either intended to deceive the Bank or acted with gross recklessness, full discharge will be denied." *In Re Martin*, 761 F.2d at 1166-1167. This Court must follow the Sixth Circuit Court of Appeals. Therefore, the gross reckless standard was properly applied.

Woolum argues that even if the gross recklessness standard applies, his conduct did not reach that level. He claims that the release of the garnishment appeared to vindicate his faith in his brother-in-law and he properly trusted this close relative. However, the undersigned must agree with the Bankruptcy Court that the appellant acted in a grossly reckless fashion in not fully disclosing his financial affairs to Bank One. He said nothing about the Owen-Corning debt even after the notification of the lawsuit in March of 1989 and prior to the release of the garnishment. He did not tell them about the All Weather Insulation obligation. Considering the debtor's level of education and business experience, these omissions were certainly grossly reckless. Indeed, the record would easily support a finding of actual, deliberate intent to deceive. Therefore, the third element is certainly established.

The Court turns to the issue of the fourth element concerning reasonable reliance by Bank One on the false financial statements. In order to prevail upon this point, a creditor must prove (1) it actually relied upon the financial statement, and (2) that this reliance was reasonable. *In Re Myers*, 124 B.R. 735 (Bankr. S.D.

Ohio 1991). The first issue would appear to constitute a factual question, which should be reviewed under the clearly erroneous standard, while the second issue would present, at the least, a mixed question of law and fact requiring a *de novo* review. *In the Matter of Locard*, 884 F.2d 1171 (9th Cir. 1989). As to the June 23, 1989 loan for $225,000.00, the undersigned concludes that the Bankruptcy Court's determination that Bank One relied upon the submitted financial statement, while somewhat dubious, is not clearly erroneous. Therefore, the first requirement of the fourth element is satisfied.

As to the second requirement, the undersigned finds that, while Bank One may have relied upon the financial statements for the June 23, 1989 loan, such reliance was clearly unreasonable due to a variety of factors. In making its determination of reasonableness, a court must consider all of the facts and circumstances of the case. *In Re Martin*, 761 F.2d at 1166. The last financial statement was dated April 11, 1989 and so was apparently submitted two months prior to the June 23, 1989 loan. However, this financial statement was not signed by Woolum. "A financial statement without a signature lacks the formality envisioned to deny discharge under Section 523(a)(2)(A) and (B) of the Code." *In Re Pederson*, 1987 Bankr. Lexis 235 (Bankr. D. Mont. 1987). The undersigned notes that Rumpke reported that Bank One policy required original signatures for financial statements. "Typically we will get an original signature." (Tr. 42). However, none was obtained on the April 11, 1989 statement. Therefore, to rely upon it would violate the bank's own established policy. When creditors fail to follow their own established policies, their alleged reliance on a false financial statement cannot be said to be reasonable. *In Re Jacox*, 115 B.R. 218 (Bankr. D. Neb. 1988). Therefore, due to the lack of a signature, the April, 1989 financial statement could not be reasonably relied upon by Bank One.

Appendix B

The Court notes that the other three financial statements were properly signed. The most recent signed statement was submitted in September, 1988. This statement was approximately nine months old at the time of the June 23, 1989 loan. This period of time would appear to make the financial statement stale. Where a creditor relies on stale financial statement, it fails to show reasonable reliance. *In Re Wing*, 96 B.R. 369 (Bankr. M.D. Fla. 1989).

The record contains numerous other "red flags" which indicate that the reliance of Bank One upon the financial statements was unreasonable. None of the financial statements were completely filled out, information concerning contingent liability, profit and loss, and estimates of annual expenses were left blank. (Def. Exh. 1-4). Bank policy required the financial statements to be completely filled out. (Tr. 39). As previously stated, failure by a creditor to follow its own policies is negates a claim of reasonable reliance.

Woolum incorrectly listed property that he owned jointly with his wife as own and did not list his partners on jointly owned property, inaccuracies of which Rumpke was aware. (Tr. 83). Reliance upon a financial statement by a creditor is unreasonable when the creditor, himself, knows of inaccuracies. *In Re Perez*, 52 B.R. 824 (Bankr. W.D. Ky. 1985).

The attempted garnishment in May of 1989 provided Bank One with at least constructive notice that Woolum had obligations he was not disclosing. In June of 1989, the bank authorized an unsecured loan to the appellant (allegedly based on the false financial statements) inspite of the fact that since May, 1989, notice of an attempted garnishment concerning a debt about which the financial statements said nothing, was sitting in the files of the office responsible for garnishments. "The Court finds that any

reliance on the part of the Bank on the various personal financial followed by any of the local banks. However, this does not explain why loan officer Rumpke did not herself check with the garnishment office. Had she done so, she would almost certainly have been able to discover the obligation to Owens-Corning and perhaps much more. Such action would seem particularly appropriate on such a large, unsecured loan as that of June 23, 1989. Bank One's failure to take notice of the garnishment in its own files does not by itself indicate unreasonable reliance, but is part of a general pattern. Thus, any reliance upon the financial statements was clearly unreasonable under the circumstances of the case as to the June 23, 1989 loan.

The February 1, 1990 loan was also purportedly made based on the same financial statements as the June 23, 1989 loan and so reasonable reliance must fail as to it as well for the same aforementioned reasons. However, the undersigned takes note of the following factors which make the finding of reliance upon the financial statements clearly erroneous in the circumstance of this loan. The bank maintains it made the February 1, 1990 loan based the financial statements indicating net assets of 1.3 to 1.4 million dollars. However, by the time of the February, 1990 loan, Rumpke was clearly aware of the debtor's obligations on the two loans from Bank One itself, for a total of $425,000.00 and was also aware of his obligation for $7,100,000.00 to Kentucky Central. Thus, the bank knew Woolum did not have a 1.3 million in net assets but owed at least 6.1 million dollars more than the value of his assets. A claim of reliance can be so unreasonable as to not constitute reliance at all. *In Re Weiner,* 86 B.R. 912 (Bankr. N.D. Ohio 1988). Therefore, Bank One could not possibly have been relying on the financial statements in making this loan. Furthermore, the record contains a cashiers check (Def. Exh. 9) dated January 6, 1990 which makes it appear that the bank dispersed the funds on the

February, 1990 loan prior to its approval. These circumstances indicate that Bank One was eager to make the loan and did not place any reliance on the false financial statements.

The Court concludes that the Bankruptcy Court's decision must be reversed. Bank One has proven that Woolum intentionally deceived it in submitting the false financial statements within the meaning of Section 523(a)(2)(B). The finding of the Bankruptcy Court that the appellee relied in the financial statements in making the two loans, while clearly erroneous as to the February, 1990 transaction, is not clearly erroneous as to the June 23, 1989 loan. However, even if there was actual reliance such reliance was clearly not reasonable for either loan under the circumstance of the case and so the decision of the Bankruptcy Court is reversed. A separate order will be entered simultaneously consistent with this opinion.

This the 20th Day of December, 1991.

s/ G. Wix Unthank
G. WIX UNTHANK
SENIOR JUDGE

Appendix B

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY
LONDON

CIVIL ACTION NO. 91-254

JERRY WOOLUM,

APPELLANT,

VS.

BANK ONE, LEXINGTON, N.A.,

APPELLEES,

ORDER

* * * * * * * * * *

In accordance with the memorandum opinion entered this same date,

IT IS HEREBY ORDERED that:

(1) the decision of the Bankruptcy Court is REVERSED;

(2) the appeal of the appellant is GRANTED; and

(2) the case be stricken from the active docket of this Court.

This the 20th Day of December, 1991.

s/ G. Wix Unthank
G. WIX UNTHANK
SENIOR JUDGE

Appendix B

[stamped]
NOTICE IS HEREBY GIVEN OF THE
ENTRY OF THIS ORDER OR JUDGMENT
ON 12-20-91
LESLIE G. WHITMER, CLERK
BY: illegible

APPENDIX C — JUDGMENT OF THE UNITED STATES BANKRUPTCY COURT, EASTERN DISTRICT OF KENTUCKY, CORBIN DIVISION FILED SEPTEMBER 4, 1991

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
CORBIN DIVISION

CASE NO. 90-6-0621

ADV. NO. 90-382

IN RE:

JERRY WOLLUM, M.D. and KAYETTA WOOLUM

DEBTORS

BANK ONE, LEXINGTON, NA

PLAINTIFF

VS.

JERRY WOOLUM

DEFENDANT

JUDGMENT

The trial of this matter was called on August 22, 1991 in Corbin, Kentucky. The parties first advised the Court that the Plaintiff would not pursue its objection to the Debtor's discharge pursuant to 11 U.S.C. 727 but would proceed with its two counts of exception to discharge pursuant to 11 U.S.C. 523. The parties

then proceeded to conduct the trial of this matter. At the close of each parties' evidence, and after considering the arguments of counsel, the Court's findings of fact were made in open court pursuant to Bankruptcy Rule 7052, and are not repeated herein. In accordance with its findings of fact, this Court makes the following conclusions of law and enters the following judgment:

1. This Court has jurisdiction over this matter.

2. This matter is a core proceeding.

3. The parties have stipulated and the Court finds that in order to obtain money from the Plaintiff the Debtor/Defendant, Dr. Jerry Woolum, delivered to Bank One, Lexington, N.A. a written financial statement which was materially false. The financial statement purported to represent Dr. Woolum's financial situation.

4. In reliance on the financial statement, Plaintiff loaned money to Dr. Woolum on June 23, 1989. Also in reliance on the financial statement, Plaintiff renewed a loan to Dr. Woolum on February 1, 1990.

5. The Court finds that the Plaintiff's reliance on the financial statement was reasonable.

6. The Court finds that the statements contained in the financial statement were so grossly reckless as to constitute an intent to deceive the Plaintiff within the meaning of § 523(a)(2)(B)(iv).

7. The Court finds that the Plaintiff has proved each element of its two claims for an exception to discharge pursuant to 11 U.S.C. § 523(a)(2)(B) by a preponderance of the evidence.

Appendix C

8. Defendant's obligations to the Plaintiff — consisting of: (a) a note dated June 23, 1989 in the principal amount of $225,000.00 plus interest in accordance with the terms of the note in the sum of $30,131.26 as of August 22, 1991 and $65.63 per day thereafter until the date of judgment and then at the legal rate for federal judgments until paid; and (b) a note dated February 1, 1990 in the principal sum of $74,865.99 plus interest in accordance with the terms of the note in the sum of $10,625.98 as of August 22, 1991 and $20.28 per day thereafter until the date of judgment and then at the legal rate for federal judgments until paid — are excepted from discharge.

9. This is a final and appealable order and there is no just cause for delay.

Given this 4 day of Sept, 1991.

s/ William Howard
Judge William Howard, United States Bankruptcy Court

Presented By:
s/ Katherine A. Adams
KATHERINE A. ADAMS
JACKSON & KELLY
Suite 500
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Appendix C

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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
CORBIN DIVISION

CASE NO. 90-6-0621

ADV. NO 90-382

IN RE:

JERRY WOOLUM, M.D. and KAYETTA WOOLUM

DEBTORS

BANK ONE, LEXINGTON, NA

PLAINTIFF

VS.

JERRY WOLLUM

DEFENDANT

FINDINGS OF FACT AND CONCLUSIONS OF LAW

THE COURT:

The Court has considered the evidence presented to it here today and makes the following findings and conclusions. First, the Court makes these conclusions and findings pursuant to Bankruptcy Rule 7052 and Civil Rule on the record and in open

court. The Court would first like to thank the attorneys for a very effective and succinct presentation here today. Contrary to common argument having two good attorneys argue a case does not make it easier: it makes it harder, but I would rather have it with good attorneys.

This Court has jurisdiction in this matter by virtue of 28 United States Code, Section 1334. This is a core proceeding pursuant to 28 USC 157-B as a determination of the dischargeability of debts of a debtor in a proceeding before the United States Bankruptcy Court. The standard of proof involved here today is that of a preponderance of the evidence pursuant to Grogan versus Garner, recent United States Supreme Court case. The Court adopts the stipulations of the parties herein which are part of this record as part of its findings in this matter and will not repeat them at this juncture since they are not already part of the record.

The Court also reserves the right to mend the finding and conclusions pending entry of a final judgment herein. The parties have stipulated the two of the four elements that are required to prove the non-dischargeability pursuant to Section 523A(2)(b) of the Bankruptcy Code as has been alleged. Plaintiff has withdrawn the count of the complaint alleging a claim of objection to the discharge of the debtor. So that is not before the Court at this point in time. The Court is only dealing with the dischargeability of the debts of the debtor to this plaintiff as enumerated in the complaint.

The parties have stipulated that the financial statements involved contain material falsity. They have also stipulated the financial statements were given with respect to the financial condition of the defendant, Jerry Woolum. Those matters were given facts in this situation and the stipulations are basically unavoidable.

Appendix C

The other two elements of the allegations necessary to prove a non-dischargeability for false statement in writing respecting financial condition are the bank's reasonable reliance on the statements and the intent to deceive.

It is the argument of the bank that the bank reasonably relied on the financial statements and that the statements were given with intent to deceive. The defendant counters and argues the reasonableness of any reliance by the bank under the conditions and facts in this case and argues at any rate, it is clear that the defendant had no intent to deceive.

The testimony in part of the defendant and the plaintiff's witness, Ms. Rumpke, both appears to the Court to be good, frank, honest and reliable testimony of their recollection of matters as best they recall them. The Court must put great credibility in the statements of both parties.

The central matters here involve the giving of a financial statement, a course of financial statements, the first of which was given to the bank by the defendant on February 29, 1988, and was followed for reasons unexplained by a second financial statement of March 28, 1988, substantially the same assets and liabilities contained therein.

The first loan was made on April 22, 1988 in the principal amount of $70,725. That loan was then renewed on April 29, 1989. The principal was subsequently reduced and effective a new renewal on February 1, 1990 with the additional advancement of a sum of slightly more than $15,000.

A third financial statement was given in September of 1988 and a fourth financial statement on April 11, 1989. A second loan

was made on June 23, 1990 in the amount of $225,000. That loan was unsecured. The first loan in the amount of $70,725 was secured by a partnership interest that the debtor owned.

It has been stipulated that there were undisclosed liabilities with respect to the financial statements involved. The Court must focus in particular on the financial statement of April 11, 1989. The defendant had executed on December 14, 1982, a guaranty for Custom Builders Insulation Supply, Inc., a corporation in which he had an interest as a stockholder. The corporation was operated by his brother-in-law. That corporation experienced financial problems at one point in 1988 or early 1989, at which time defendant incurred debt in order to pay off tax debts of Custom Builders Insulation Supply, Inc.

In March of 1989, particularly March 3, the defendant was served with a summons by mail wherein he was sued by Owens Corning company for $388,595.69. This occurred, of course, prior to the financial statement of April 11, 1989. That financial statement, while not signed by the defendant, has been admitted by him as having been prepared by or under his direction and delivered to the bank on his behalf.

The defendant has testified that he relied upon statements of his brother-in-law; that the indebtedness to Corning was a mistake, and that there in fact was no indebtedness. There is some evidence before the Court that might lead him to believe the brother-in-law's statements in that a garnishment issued against the defendant's accounts was shortly withdrawn. The question before the Court is whether or not the defendant acted recklessly in omitting this liability and one other liability from his financial statement. The other liability is to All Weather Insulation Company. It appears from the documents before the Court that a letter was written to and

received by the defendant dated June 1, 1989 indicating that his guaranty to All Weather of October 25, 1988 was being inforced as to a liability of $76,760.95.

In reviewing the evidence, the Court must conclude that the defendant acted in a gross reckless manner in not informing by way of listing on the financial statement the liabilities which had been asserted against him and in particular, the Owens Corning liability in the amount of $388,000.

The Court believes the defendant's testimony in this regard and believes the defendant simply exercised extremely poor judgment in not retaining counsel to investigate the facts concerning his liability on the Owens Corning debt.

The Court therefore concludes that based upon the gross recklessness of the defendant, that the only issue left before the Court is the reasonableness of the bank in reliance on the financial statements involved and particularly, the April 11, 1989 financial statement under which the $225,000-loan was made and a renewal of the previous loan along with an advancement of some $15,000-plus dollars.

While there is evidence that there were significant inconsistencies in the financial statements provided by the debtor to the bank, the Court finds the bank reasonably relied upon the financial statements and in particular, the net worth set forth therein in making the loans to the defendant. It seemed self-evident that the bank relied upon the April 11, 1989 statement, in particular, and the conduct of the bank, the Court deems to be reasonable under the circumstances.

The Court therefore finds that judgment should be entered for

the plaintiff against the defendant in the sums of $74,865.99 principal plus interest in the amount of $10,625.98 plus per diem interest thereafter until date of entry of judgment, after which time judgment should bear federal judgment rate of interest, plus the sum of $225,000, plus interest in the amount of $30,181.26 to this date plus per diem interest hereafter until date of entry of judgment, with federal judgment rate of interest thereafter; that the indebtednesses to sums of which have just been repeated are nondischargeable pursuant to Section 523A(2)(b).

The Court would direct that counsel for the plaintiff prepare a judgment so reciting and tender it to the Court for entry. It is not necessary to repeat all the findings and conclusions but simply recite that the findings and conclusions having been made pursuant to Bankruptcy Rule 705(2) on the record in open court will save counsel some considerable dictating in that matter.

Are there any questions? We stand adjourned.

OFF THE RECORD.

No. 92-1304

In The

Supreme Court of the United States

October Term, 1992

JERRY WOOLUM,

Petitioner,

vs.

BANK ONE, LEXINGTON, NA,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether a debtor's grossly reckless disregard for the veracity of his materially false financial statements constitutes an "intent to deceive" under Section 523(a)(2)(B)(iv) of the Bankruptcy Code for purposes of denying the discharge of debts obtained by use of the financial statements?

2. Whether the bankruptcy court's finding, after hearing all testimony and reviewing all documentary evidence, that a creditor reasonably relied on a debtor's materially false financial statements when extending credit to the debtor is reviewable under the clearly erroneous standard or *de novo?*

PARTIES TO THE PROCEEDINGS

Bank One, Lexington, NA, the respondent herein, was the appellant in the proceeding below. Jerry Woolum, the petitioner herein, was the appellee in the proceeding below.

Bank One, Lexington, NA is a wholly owned subsidiary of Banc One Corporation.

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No. 92-1304

In The

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JERRY WOOLUM,

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vs.

BANK ONE, LEXINGTON, NA,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

OPINIONS BELOW

The opinion and judgment of the United States Court of Appeals for the Sixth Circuit reversing the decision of the district court are reproduced in petitioner's appendix (A[p]1a - A[p]12a)[1] and the opinion is reported as *In re Woolum*, 979 F.2d 71 (6th Cir. 1992).

1. Reference to the appendix of the Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit shall be made as (A[p] __a).

The unreported memorandum opinion and order of the United States District Court for the Eastern District of Kentucky are reproduced in petitioner's appendix (A[p]12a - A[p]23a).

The unreported order, judgment, and findings of fact and conclusions of law of the United States Bankruptcy Court for the Eastern District of Kentucky are reproduced in petitioner's appendix (A[p]24a - A[p]34a).

STATUTORY PROVISIONS INVOLVED

1. Section 523(a) of Title 11 of the United States Code provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b) or 1328(b) of this title does not discharge an individual debtor from any debt —
>
> * * *
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by —
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> (B) use of a statement in writing —
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;

> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive;
>
> . . . .

2. Rule 8013 of the Federal Rules of Bankruptcy Procedure provides:

> On an appeal the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.

STATEMENT OF THE CASE

The proceedings below arose out of an adversary action commenced by respondent Bank One, Lexington, NA ("Bank One") against petitioner Jerry Woolum ("Dr. Woolum") in Dr. Woolum's voluntary Chapter 7 bankruptcy proceeding. Bank One brought the action to bar the discharge of Dr. Woolum's outstanding indebtedness to Bank One under 11 U.S.C. § 523(a)(2)(B). The parties stipulated that Dr. Woolum's financial statements were materially false and were given with respect to his financial condition, thereby satisfying two of the four elements of § 523(a)(2)(B). Following an evidentiary hearing at which Dr.

Woolum and Bank One loan officer, Linda Rumpke ("Rumpke") testified, the bankruptcy court found that Dr. Woolum acted in a grossly reckless manner by failing to list substantial liabilities on his financial statements and that Bank One reasonably relied on Dr. Woolum's financial statements when making loans to Dr. Woolum. Thus the bankruptcy court found that the two remaining elements of § 523(a)(2)(B) had been satisfied and held that Dr. Woolum's indebtedness to Bank One was nondischargeable.

The bankruptcy court's decision rested on its careful analysis of the factual matters revealed during the hearing and the inferences it drew therefrom. Such matters included the historical relationship between Dr. Woolum and Bank One, Dr. Woolum's extensive investment and real estate development experience, Bank One's ordinary and customary procedures in reviewing requests for loans, Rumpke's actual review of Dr. Woolum's credit bureau report, tax returns and financial statements, the substantial amount of Dr. Woolum's undisclosed liabilities, the litigation related to those liabilities and the standard procedures followed by Bank One and other banks when responding to garnishments against individuals that have no accounts with the bank. The nature and complexity of the many factual issues in this case is significant because it illuminates the proper role of the bankruptcy court in actions brought to deny discharge of debts under § 523(a)(2) and the correctness of the opinion below. Although petitioner omits many of these facts from his statement of the case, the opinion below contains a concise statement (A[p]2a - A[p]3a) which is incorporated herein by reference for the sake of brevity. The additional factual references contained throughout the opinion below (A[p]4a - A[p]11a) are also indicative of the factually intensive nature of this and other nondischargeability actions.[2]

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2. The petitioner's statement of the case contains a misstatement of fact which could bear on the importance of the issues which he seeks to present. Contrary to petitioner's assertion, the bankruptcy court did not expressly find

(Cont'd)

SUMMARY OF ARGUMENT

Neither of the questions presented by the petition merit this Court's review. With regard to the first, this Court long ago held that a written statement made "either with actual knowledge that it was incorrect, or with reckless indifference to the actual facts" was sufficient to deny the discharge of a debtor's obligations under the Bankruptcy Act of 1898. *Morimura, Arai & Co. v. Taback*, 279 U.S. 24, 33 (1929). As recently stated by this Court, the present Bankruptcy Code should not be read "to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 563 (1990). Congress has never questioned the validity of *Morimura* and the Courts of Appeal have uniformly held that reckless indifference is sufficient to establish an intent to deceive under § 523(a)(2) and its predecessors. *See, e.g., Carini v. Matera*, 592 F.2d 378 (7th Cir. 1979); *In re Houtman*, 568 F.2d 651 (9th Cir. 1978); *David v. Annapolis Banking & Trust Co.*, 209 F.2d 343 (4th Cir. 1953). Thus the decision below equating reckless conduct with intent to deceive is completely harmonious with the Bankruptcy Code and the decisions of this Court and all other Courts of Appeal.

Similarly, with respect to the second question, the decision below of the Court of Appeals to apply the clearly erroneous

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(Cont'd)
that Dr. Woolum did not intend to deceive Bank One. Petition at 7. Rather, the bankruptcy court started from the premise that a debtor's reckless disregard of outstanding liabilities was sufficient to deny discharge and focused on whether Dr. Woolum's conduct was reckless. (A[p]32a — A[p]33a). Although the bankruptcy court's approach was entirely correct, in light of the district court's subsequent statement that "the record would easily support a finding of actual, deliberate intent to deceive" (A[p]19a), it appears that the decision below is correct without regard to the question of whether reckless disregard satisfies the intent element.

standard of review to the bankruptcy court's finding of reasonable reliance is consistent with the overwhelming weight of authority in the Courts of Appeal. *See, e.g., In re Lansford,* 822 F.2d 902 (9th Cir. 1987); *In re Collins,* 946 F.2d 815 (11th Cir. 1991). Although, in affirming a district court's finding of reasonable reliance, the Fifth Circuit once followed the *de novo* standard, the issue of the proper standard of review was not determinative and apparently not raised. *Matter of Jordan,* 927 F.2d 221 (5th Cir. 1991). Accordingly, subsequent Fifth Circuit opinions have not followed *Jordan's* statement regarding *de novo* review of reasonableness. Moreover, given the inherently factual nature of the concept of "reasonableness", *de novo* review of findings of reasonableness would run counter to this Court's rationale in *Anderson v. Bessemer City,* 470 U.S. 564 (1985). Simply stated, notwithstanding the number of bankruptcy cases filed each year, this Court's review of this question is unnecessary as there is nothing to add to this correct, fair and well established point of bankruptcy law. Indeed, any concern regarding the increasing volume of bankruptcy cases is itself a sufficient reason to reject petitioner's argument since *de novo* review of reasonableness findings would only impose further burdens on the district courts and courts of appeal.

REASONS FOR DENYING THE WRIT

I.

THE DECISION BELOW THAT RECKLESS DISREGARD FOR THE TRUTH CONSTITUTES INTENT TO DECEIVE UNDER SECTION 523(a)(2)(B)(iv) IS CONSISTENT WITH THE BANKRUPTCY CODE AND ALL DECISIONS OF THIS COURT AND THE CIRCUITS.

Guided by the established and uniform law of the Courts of Appeal, the bankruptcy court framed the issue as whether Dr. Woolum acted recklessly in omitting substantial guaranty

obligations from his financial statements and then found, based on the evidence, that Dr. Woolum had indeed acted grossly reckless. (A[p]32a - A[p]33a). The district court affirmed that reckless conduct satisfied the intent element and further found that "the record would easily support a finding of actual, deliberate intent to deceive," considering Dr. Woolum's education and business experience and particularly his failure to disclose the $388,000 Owens-Corning obligation after he had been sued on it. (A[p]18a - A[p]19a). The Court of Appeals, relying on its decision in *In re Martin*, 761 F.2d 1163 (6th Cir. 1985), affirmed and held that "gross recklessness is sufficient to establish an intent to deceive." (A[p]4a).

Petitioner seeks to have this Court overturn this established body of law because § 523(a)(2)(B)(iv) does not contain the word "reckless." Petitioner supports this request, without citation to a single decision regarding intent or reckless conduct, on the ground that the statute is plain on its face and that analysis of a bankruptcy section begins and ends with the language of the statute itself. In previously construing the Bankruptcy Code, however, this Court has warned "we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Kelly v. Robinson*, 479 U.S. 36, 43 (1986). Moreover, as stated by this Court, "[t]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. (citation omitted). The Court has followed this rule with particular care in construing the scope of bankruptcy codifications." *Midlantic National Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 501 (1986).

When Congress enacted § 523(a)(2) of the Bankruptcy Code of 1978, the judicial practice of inferring intent to deceive from reckless disregard of the truth was well established in actions brought under the Bankruptcy Act of 1898 to deny a debtor's

discharge for use of false statements. In *Morimura, Arai & Co., v. Taback*, 279 U.S. 24 (1929), this Court construed a provision of the 1898 Act that completely barred discharge of all debts if the debtor had obtained property on credit by use of a materially false statement in writing. Under the 1898 Act, the term materially false connoted more than incorrectness and required intent on the part of the debtor. This Court held that such intent was established if the written statement "was made and acquiesced in either with actual knowledge that it was incorrect, or with reckless indifference to the actual facts, without examining the available source of knowledge which lay at hand, and with no reasonable ground to believe that it was in fact correct." *Morimura*, 279 U.S. at 33.

Similarly, prior to the enactment of § 523(a)(2), the Courts of Appeal had consistently held that reckless conduct was sufficient to establish an intent to deceive under its predecessor, § 17(a)(2) of the Bankruptcy Act.[3] For example, in reaching that conclusion, the Ninth Circuit analyzed *Morimura* and reasoned that requiring actual knowledge "would have the incongruous effect of imposing

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3. Section 17(a)(2) of the Bankruptcy Act provided in relevant part:

> (a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts . . . except such as . . . .
>
> (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published in any manner whatsoever with intent to deceive, or for willful malicious conversion of property of another.

Bankruptcy Act § 17(a)(2) (formerly codified at 11 U.S.C. § 35(a)(2)) (repealed 1978).

a stricter standard for exempting a single debt from discharge than formerly was required to completely bar discharge of all debts." *In re Houtman*, 568 F.2d 651, 656 (9th Cir. 1978). The Fourth Circuit held that reckless indifference was sufficient and affirmed the decision of the lower court denying discharge to a wife who allowed her husband to submit a false financial statement on her behalf without verifying its accuracy. *David v. Annapolis Banking & Trust Co.*, 209 F.2d 343 (4th Cir. 1953). The Seventh Circuit stated that where "a person knowingly or recklessly makes a false representation which the person knows or should know, will induce another to make a loan, intent to deceive may logically be inferred." *Carini v. Matera*, 592 F.2d 378, 380 (7th Cir. 1979). *Accord Matter of Bardwell*, 610 F.2d 228 (5th Cir. 1980); *Woolen Corporation of America v. Gitnig*, 33 F.2d 259 (3rd Cir. 1929).

There is no indication that Congress intended to alter this long standing bankruptcy practice when it enacted § 523(a)(2)(B). To the contrary, there is every reason to believe that Congress intended for the practice to continue. The legislative history notes that "[s]ection 523(a)(2)(B)(iv) is not intended to change from present law . . . ." 124 Cong. Rec. 32350, 32399 (statements of Rep. Don Edwards). Thus it is not surprising that, subsequent to the enactment of § 523(a)(2), Courts of Appeal still follow the cases construing the 1898 Act holding that reckless indifference of the truth is sufficient to bar discharge. *See, e.g., Birmingham Trust National Bank v. Case*, 755 F.2d 1474 (11th Cir. 1985); *Matter of Walker*, 726 F.2d 452 (8th Cir. 1984).

In sum, the Court of Appeals' decision on this issue is harmonious with the decisions of this Court and the other Circuits and, in light of this Court's instructions for construing the Bankruptcy Code, the petition does not present an issue of substantial importance warranting this Court's review.

II.

THE DECISION BELOW APPLYING THE CLEARLY ERRONEOUS STANDARD OF REVIEW TO THE BANKRUPTCY COURT'S FINDING OF REASONABLE RELIANCE IS CONSISTENT WITH THE OVERWHELMING WEIGHT OF AUTHORITY IN THE CIRCUITS.

After hearing all the testimony and reviewing all the evidence submitted during the hearing, the bankruptcy court found that Bank One reasonably relied on Dr. Woolum's materially false financial statements. On appeal, the district court conducted a second full scale review of the evidence and, after drawing its own inferences, reversed the bankruptcy court's finding of reasonable reliance. In order to reach that result, the district court concluded that it was entitled to conduct a *de novo* review of the bankruptcy court's finding based on *Matter of Lockard*, 884 F.2d 1171 (9th Cir. 1989), a case that did not involve a nondischargeability action. The Court of Appeals held that the district court committed reversible error in applying the *de novo* standard of review declaring that "[w]hether a creditor's reliance was reasonable is a factual determination to be made in light of the totality of the circumstances." (A[p]9a).

Petitioner requests review by this Court to resolve a perceived conflict arising from a Fifth Circuit opinion and to impose the *de novo* standard after necessarily ignoring the overwhelming authority among the Circuits and this Court's own holdings. Petitioner cites no cases involving a finding of reasonableness, but instead relies on various cases ascribing legal status to statutory terms such as "farming operation", "constructive trust", "fiduciary", and "substantial abuse."[4] Given the correctness of the

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4. Unlike the fundamental concept of reasonableness, these terms have no generally recognized meaning in the absence of their statutory definitions and judicial interpretations.

decision below, its accord with this Court's rationale in *Anderson v. Bessemer City*, 470 U.S. 564 (1985), and the practical insignificance of the Fifth Circuit's contrary statement, there is no important reason for review by this Court.

When squarely faced with the determinative question of whether a finding of reasonable reliance under § 523(a)(2)(B) is reviewable *de novo* or under the clearly erroneous standard, the Courts of Appeal have uniformly applied the clearly erroneous standard. For example, the Ninth Circuit held that "[w]hether the misrepresentations were material under the circumstances, whether there was reasonable reliance, and whether there was intent to deceive are issues of fact." *In re Lansford*, 822 F.2d 902, 904 (9th Cir. 1987). In reversing a contrary conclusion reached by a district court, the Seventh Circuit explained:

> This Court, however, has held that a bankruptcy court's determination of dischargeability is subject to a clearly erroneous standard of review. (citation omitted). Here, the bankruptcy court held two days of trial and was able to closely evaluate the witnesses' testimony. Absent an abuse of discretion, an appellate court should not attempt to redetermine credibility of witnesses.

Matter of Bonnett, 895 F.2d 1155, 1157 (7th Cir. 1990). The Tenth Circuit stated that the reasonableness of a creditor's reliance was a finding of fact to "be evaluated according to the particular facts and circumstances present in a given case." *In re Mullet*, 817 F.2d 677, 679 (10th Cir. 1987). *Accord In re Collins*, 946 F.2d 815 (11th Cir. 1991); *In re Ashley*, 903 F.2d 599 (9th Cir. 1990).

In an effort to create some glimmer of uncertainty in this well

settled area of the law, petitioner can offer only the case of *Matter of Jordan*, 927 F.2d 221 (5th Cir. 1991). There are numerous problems with the opinion in *Jordan* which undermine its status as conflicting authority or, at the very least, establish that whatever conflict it creates has no practical significance and does not require immediate resolution by this Court. First, it is unclear from the opinion whether the issue of the appropriate standard of review was raised in *Jordan*. In *Jordan*, the district court found that the creditor had reasonably relied on the debtor's financial statements. On appeal, the Fifth Circuit matter-of-factly announced that the finding was a conclusion of law, but it is unclear whether the creditor had argued any differently. Given that the Fifth Circuit affirmed the district court's finding, the application of the less deferential standard was not determinative of the outcome in the case.

Second, the two cases relied on by the Fifth Circuit did not support its holding. One of the cases, *In re Bonnett*, 73 B.R. 715 (C.D. Ill. 1987), had already been reversed on appeal by the Seventh Circuit in *Matter of Bonnett*, 895 F.2d 1155 (7th Cir. 1989). The other citation, *In re Martz*, 88 B.R. 663 (Bankr. E.D. Pa. 1988), is a bankruptcy court decision which did not involve an issue of appellate review and never mentioned the clearly erroneous or the *de novo* standard.

Third, subsequent Fifth Circuit cases appear to apply the clearly erroneous standard to review of reasonableness findings despite *Jordan's* contrary statement of law. For example, in *Matter of Luce*, 960 F.2d 1277 (5th Cir. 1992), the Fifth Circuit cited *Jordan* for the general proposition that findings of fact are reviewable under the clearly erroneous standard and conclusions of law are reviewable *de novo*. The court then stated, however, that "[s]ince '[d]eterminations as to the dischargeability of debts under section 523 are reviewed under the clearly erroneous standard,' we subject only the bankruptcy court's conclusions as to attorney's fees to *de novo* review." *Luce*, 960 F.2d at 1280.

Finally, the Fifth Circuit itself appears to have questions regarding the merits of *Jordan's* invasion of the bankruptcy court's fact finding role. In *Matter of Coston*, 977 F.2d 175, 180 (5th Cir. 1992), *reh'g en banc granted*, 980 F.2d 1513 (5th Cir. 1993), the Fifth Circuit, in an admitted "close call", reversed the decisions of the two lower courts solely on the issue of reasonable reliance, and, in so doing, followed its decision in *Jordan*.

A majority of the judges on the Fifth Circuit have since voted in favor of granting a rehearing *en banc*, withdrawing the opinion in *Coston* — the only apparent issue for decision being the continued prudence of its lonely stance in *Jordan*. *Matter of Coston*, 980 F.2d 1513 (5th Cir. 1993). Thus the illusory and insignificant split relied on by Dr. Woolum stands ready to be corrected in the forum of its creation, leaving nothing to necessitate review by this Court.

III.

THE COURT OF APPEALS' DECISION THAT A FINDING OF REASONABLE RELIANCE IS A FINDING OF FACT SUBJECT TO THE CLEARLY ERRONEOUS STANDARD OF REVIEW IS CONSISTENT WITH THE DECISIONS OF THIS COURT.

This Court early on recognized the inherent factual nature of a finding of reasonableness. In construing a bankruptcy statute that conditioned avoidance of a transfer of property on a finding that the person receiving it had "reasonable cause to believe that it was intended thereby to give a preference," this Court held that "[w]hether such 'reasonable cause to believe' existed is a question of fact." *Pyle v. Texas Transport & Terminal Co.*, 238 U.S. 90, 98 (1915).

In the case below, the district court's disagreement with the bankruptcy court's finding of reasonable reliance turned not so

much on legal points as on disputed facts and inferences. For example, the district court disputed Bank One's reliance on an unsigned financial statement, yet ignored the evidence that Dr. Woolum acknowledged to Bank One that the unsigned statement was his and submitted for the same purpose as a signed one. The district court found that a nine month old statement could not be relied on, but glossed over Bank One's testimony that the bank customarily relied on financial statements for up to one year. Although the undisputed evidence in the record established that neither local banks nor Bank One would customarily notify their loan officers when a garnishment was attempted against someone who had no accounts with the bank, the district court found that the garnishment clerk should have notified Rumpke and that it was unreasonable for Rumpke not to check other branches and departments of the bank for garnishments before making a loan. In essence, the district court substituted its own business judgment for that of Bank One.

This case illustrates that anytime there is evidence on both sides of an issue one fact finder may always reach a different conclusion than the other. It is for this reason that the clearly erroneous standard is mandated for review of factual findings. As this Court explained:

> The rationale for deference to the original finder of fact is not limited to the superiority of the trial judge's position to make determinations of credibility. The trial judge's major role is the determination of fact, and with experience in fulfilling that role comes expertise. Duplication of the trial judge's efforts in the court of appeals would very likely contribute only negligibly to the accuracy of fact determination at a huge cost in diversion of judicial resources. In addition, the parties to a

> case on appeal have already been forced to concentrate their energies and resources on persuading the trial judge that their account of the facts is the correct one; requiring them to persuade three more judges at the appellate level is requiring too much.

Anderson v. Bessemer City, 470 U.S. 564, 574-75 (1985).

As a result of its inherent factual nature, there could never be a general rule or touchstone as to what constitutes reasonable reliance. What is reasonable depends on a potentially endless array of variables which can only be evaluated as each case arises. Thus there is simply no reason to expend the valuable time of an appellate court in reviewing the bankruptcy court's finding on this issue. As noted above, subsequent review of such a finding would not likely increase its accuracy, yet would divert the valuable resources of the court and the parties.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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